

**STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street, 24th Floor
San Francisco, California 94105**

INITIAL STATEMENT OF REASONS

Date: April 7, 2006

Regulation File: RH0203855

VIATICAL SETTLEMENT REGULATION

INTRODUCTION

Pursuant to Insurance Code section 10113.1 and 10113.2, Insurance Commissioner John Garamendi proposes to add to California Code of Regulations, Title 10, Chapter 5, Subchapter 3, Article 12.9, new sections 2548.1 through 2548.8, entitled, "Viatical Settlement Regulation." This regulation is being proposed for the purpose of clarifying the viatical settlement provisions of the California Insurance Code ("CIC" or "Insurance Code"). The proposed regulation contains important definitions of key terms used in the viatical settlement statute, provides guidelines for what disclosures must be made to the viator at the time of an offer, requires the viatical settlement company to escrow viator funds, and specifies the grounds for the denial or revocation of a viatical settlement license.

SPECIFIC PURPOSE AND REASONABLE NECESSITY

The specific purpose of each adoption and the rationale for the Commissioner's determination that each adoption is reasonably necessary to carry out the purpose for which it is proposed are set forth below.

Section 2548.2(a)

Proposed section 2548.2(a) provides an important definition of the phrase, "catastrophic or life threatening illness or condition." The latter phrase is used in section 10113.1(a)(1) of the CIC to define what constitutes a viatical transaction, but the code is silent on which medical conditions constitute a life threatening or catastrophic illness or condition. Proposed section 2548.2(a) is necessary in that it provides clarity to the statute.

Section 2548.2(b)

CIC, section 10113.1(a)(1) provides that a viatical settlement is an agreement "entered into" between [a viator and a viatical settlement provider]. Proposed section 2548.2(b) defines "enters into," providing that the definition includes acquiring an ownership interest in a life insurance policy, through an assignment, purchase, bequest *or other*

transfer. This section is necessary as it resolves existing ambiguity about what “entered into” means, and clarifies that all transfers are covered, unless they are specifically exempted pursuant to proposed sections 2548.2(h) (1) and (2).

Section 2548.2(c)

CIC, section 10113.1(a)(1) provides that a viatical settlement is an agreement entered into between a *person* [with a catastrophic illness or condition] and another *person*, etc. Although the Insurance Code defines “person” at section 10113.1(a)(2), proposed section 2548.2(c) is necessary to provide continuity and ease of reference in the regulations.

Section 2548.2(d)

CIC, section 10113.2 provides that no person can enter into or solicit viatical settlements unless such person is licensed by the commissioner. The Insurance Code, however, provides no definition of “solicit.” Proposed section 2548.2(d) is necessary as it defines the word, “solicit” which could be subject to varying interpretations.

Section 2548.2(e)

CIC, section 10113.1(a)(1) defines “viatical settlement,” but the definition is not complete because it fails to include within the definition a person who is covered under a group policy. Proposed section 2548.2(e) thus clarifies that an owner of a group policy may also potentially be party to a viatical settlement transaction. Proposed section 2548.2(e) also clarifies that a viatical settlement includes any sale of a life policy subsequent to the original sale involving the viator.

Section 2548.2(f)

CIC, section 10113.1 and 10113.2 do not contain a definition of viatical settlement broker. Proposed section 2548.2(f) defines viatical settlement brokers, in part, as persons conducting business in California, who for a fee, commission or other consideration, solicits or offers the availability of viatical settlements. Proposed section 2548.2(f) also clarifies that the viatical settlement broker represents only the viator, and owes a fiduciary duty to the viator. Proposed section 2548.2(f) is necessary as it resolves an ambiguity about who is, and who is not a viatical settlement broker. In this regard, it clarifies that a viatical settlement broker does not include an attorney, accountant or financial planner who is paid solely by the viator, and without regard to whether a viatical settlement is effectuated, or an employee of a licensed viatical settlement broker.

Section 2548.2(g)

CIC, section 10113.1(a)(1) provides that a viatical settlement “is an agreement entered into between a person owning a life insurance policy upon the life of a person with a catastrophic or life-threatening illness or condition and another person by which the policy owner receives compensation. . .” CIC, section 10113.2 goes on to provide that a person cannot enter into or solicit viatical settlements without being licensed. It has been the Department’s long standing interpretation of these provisions that a person who solicits or transacts viatical settlement *investments* must also be licensed by the Commissioner. Proposed section 2548.2(g), therefore, is necessary in that it provides a definition of “viatical settlement investment broker,” and clarifies that any

individuals transacting such business are also required to be licensed. Similar to proposed section 2548.2(f)'s definition of "viatical settlement broker," viatical settlement investment broker exempts from the viatical settlement law's licensing requirements the following individuals: an attorney, accountant or financial planner if such are paid solely by the investor, and without regard to whether or not a viatical settlement is effectuated.

Section 2548.2(h)

CIC, sections 10113.1 and 10113.2 contain no definition of viatical settlement provider. Proposed section 2548.2(h) is necessary to resolve the ambiguity over what qualifies as "viatical settlement provider." Proposed section 2548.2(h) states that any person conducting business in California who enters into a viatical settlement agreement is a provider. It goes on to include within the definition of "provider" any person who has an ownership interest in the insurance policy, including a collateral ownership interest, and including subsequent owners of the policy. The latter qualification is critical, as it has been the Commissioner's long standing interpretation that third party transferees of an interest in a viatical settlement must also be licensed. Proposed section 2548.2(h) also provides clear guidelines as to which individuals or entities are not a viatical settlement provider. Consistent with CIC, section 10113.1, a bank, savings and loan association, credit union or other licensed lending institution that takes an assignment of a policy as collateral on a loan is not a provider; nor is an issuer of a life insurance policy providing accelerated benefits; nor is an employee of a licensed viatical settlement provider.

Section 2548.2(i)

The Insurance Code does not define "viator." Proposed section 2548.2(i) is necessary because it clarifies who qualifies as a "viator" within the meaning of the viatical settlement statutes and regulations. The definition of viator is broadly defined to include not only the original owner of a policy insuring the life of a person with a catastrophic or life threatening illness, but also includes a certificate holder under a group policy insuring the life of such person. It also includes any person who is considering entering into a viatical settlement.

Section 2548.3

The Department's long-standing interpretation of CIC, section 10113.1(a)(1) is that "entering into" a viatical settlement transaction covers not just the initial transfer to the viatical settlement provider, but also any subsequent or contemporaneous assignments, transfers, sales, etc., to a third party. Proposed section 2548.3 is necessary to clarify the statute in this regard, and to also clarify that any such transfers can only be to persons who are licensed, and only with the written consent of the viator.

Section 2548.4

The viatical settlement provisions of the Insurance Code are silent with respect to the important subject of third party contacts of the viator. Proposed section 2548.4 is necessary to provide guidelines for the provider in obtaining consent from the viator for such contacts; and moreover, provide guidelines as to the frequency of such contacts. Proposed section 2548.4 also requires the viatical settlement broker to explain the procedure for the contacts to the viator.

Section 2548.5

CIC, section 10113.2(d) delineates what disclosures must be made to the viator at the time of solicitation of the viatical settlement. Proposed section 2548.5 sets forth the critical disclosures that are required in writing at the time an offer is made to the viator. The first three involve: the disclosure of the affiliation between the provider and the broker and the issuer of an insurance policy, if any (2548.5 (1)); the affiliation between the provider and broker, if any (2548.4(2)), and the amount of commission to be paid to the broker (section 2548.5(3)). These disclosures are necessary because they provide information about potential conflicts of interest of those involved in viatication of a policy, and also shed light on the possible motivation of the provider or broker.

Proposed section 2548.5(4) is necessary to clarify that the viator has the right to designate a third party to whom inquiries can be made about the viator's health status; similarly proposed section 2548.5(5) protects the viator's right to know in advance that such contacts will be made, and the frequency of such contacts.

Proposed section 2548.5(6) requires the disclosure to the viator of all estimates of the viator's life expectancy; this provision is necessary to provide a means of having the viator monitor the integrity of the marketing of his or her insurance policy.

Proposed section 2548.5(7) requires bold, 12-point type disclosure to the viator of the most important of the disclosures codified at CIC, section 10113.2(d). This proposed section is necessary because the Insurance Code's disclosures are required only at the time of solicitation, and there is no requirement that they be prominently disclosed in writing. It is equally, if not more important, however, for such disclosures to be made in writing and at the time an offer to buy a policy is made.

Proposed section 2548.5(8) requires disclosure made to the viator that a viaticated policy may be resold only to an entity that holds a viatical settlement license, and only with the written permission of the viator. This provision is necessary to advise the viator that nonlicensed third parties cannot be transferred ownership interests in viaticated policies.

Section 2548.6

The Insurance Code provisions governing viatical settlements currently do not require the segregation of viatical settlement proceeds into an escrow or trust account. Proposed section 2548.6 imposes this requirement, and also requires that the escrow or trust account be maintained in a state or federally chartered, FDIC-insured institution. In addition, proposed section 2548.6 imposes a 15-day time limit for the viator to receive the proceeds from the settlement. This section is necessary in that it provides important safeguards with respect to viator funds during a pending viatical settlement transaction.

Section 2548.7

CIC, section 10113.1 and 10113.2 do not currently contain specific guidelines for avoiding conflicts of interest with the viator; nor is the Insurance Code specific about what constitute conduct is "against the public interest." (CIC, section 10113.2(b)(1) and (2).) Proposed sections 2548.7(a) through (l) are necessary to give greater clarity to

licensees as to what constitutes a conflict of interest, and what conduct is otherwise prohibited.

- Proposed section 2548.7(a): This provision prohibits a viatical settlement licensee from paying any finder's fee or commission to any person not licensed pursuant to Section 10113.2 of the California Insurance Code. This provision is consistent with CIC, section 10113.2(b)(1)'s requirement that a person cannot solicit viatical settlements without being licensed.
- Proposed section 2548.7(b): This provision prohibits a licensee from entering into a viatical settlement in which payments are to be made in installments. This provision is necessary to protect the viator's funds, which should be immediately available to viator following the completion of required documents.
- Proposed section 2548.7(c): This provision prohibits a licensee from engaging in any "unfair, deceptive or harassing" acts. This provision is necessary to underscore that licensees are to act in good faith with respect to viators.
- Proposed section 2548.7(d): This provision prevents a licensee from deducting commission from the amount paid or quoted to the viator. This provision is necessary to prevent the financial exploitation of the viator.
- Proposed section 2548.7(e): This provision prevents a viatical settlement broker from acting as a provider, unless allowed by the Commissioner. This provision is necessary to ensure that there is no conflict of interest in the roles of broker and provider.
- Proposed section 2548.7(f): This provision prohibits a licensee from acting as a viatical settlement broker after having acted as an agent or broker with respect to the same policy. The provision is necessary in order to prevent the viatical settlement broker from having a conflict of interest with the prospective viator.
- Proposed section 2548.7(g): This provision prohibits a licensee from destroying key documents pertaining to a viatical settlement transaction for a period of five years. The California Insurance Code's viatical settlement provisions currently have no records retention provisions; proposed section 2548.7(g) is necessary to ensure that viatical licensees keep appropriate records in the event that the Department is required to examine the licensee, or investigate a transaction.
- Proposed section 2548.7(h): This provision prevents a licensee from viaticating a policy during its two-year contestability period. This provision is necessary to help prevent the occurrence of "cleansheeting," whereby policies

are initially sold to ill persons, and such applicants misrepresent the true condition of their health to the insurer, and thereafter immediately attempt to sell the policies. Proposed section 2548.7(h) preserves the right of the insurance company to contest and potentially reject any policy without having any intervening viatical settlement transaction take place during the critical two-year period of contestability.

- Proposed section 2548.7(i): This provision prohibits a viatical settlement broker from acting in ways contrary to the best interests of the viator, or failing to act according to the viator's instructions. This provision is necessary to codify the broker's fiduciary obligations to the viator.
- Proposed section 2548.7(j): This provision prohibits a licensee from offering to buy a policy for an amount less than the policy's cash surrender value or accelerated benefits value. This provision is necessary to establish an important threshold for amounts below which a provider cannot offer to viaticate a policy.
- Proposed section 2548.7(k): This provision prohibits a licensee from using forms not approved by the Commissioner. This provision is necessary to reaffirm California Insurance Code section 10113.2(c)'s requirement that a licensee shall file with the Commissioner any form that it intends to use.
- Proposed section 2548.7(l): This provision prohibits the selling of an ownership interest in an entity licensed to transact viatical business to any entity or person who does not hold such license, and without authorization from the Commissioner. This provision is necessary to ensure that licensed entities do not "rent" or sell their licenses to non-licensed entities, and thereby circumvent the licensing process.

Section 2548.8 Revocation of Licensee; Denial of Application

CIC, section 10113.2(b)(2) allows the commissioner to deny an application or to revoke a person's license following a hearing at which it is determined that to keep such license would be "contrary to the interests of the public." Proposed section 2548.8 is thus necessary to offer critical guidance as to what constitutes grounds for such denial or revocation of a license, and to strengthen the Commissioner's ability to deny or revoke licenses where certain types of conduct are deemed to warrant such treatment.

Proposed section 2548.8(a): This provision makes a knowing or willful misstatement a basis for the Commissioner's revocation or denial of a license.

- Proposed section 2548.8(b): This provision makes certain criminal convictions a basis for the Commissioner's revocation or denial of a license.

- Proposed section 2548.8(c): This provision makes violations of the California Insurance Code, or those of the California Code of Regulations governing insurance a basis for the Commissioner's revocation or denial of a license.
- Proposed section 2548.8(d): This provision makes the licensee/applicant's demonstration of incompetency or untrustworthiness a basis for revocation or denial of a license.
- Proposed section 2548.8(e): This provision makes the licensee/applicant no longer meeting the qualifications for a viatical settlement license a basis for the revocation or denial of a license.
- Proposed section 2548.8(f): This provision makes the licensee/applicant's conducting of viatical business with an unlicensed company or individual a basis for revocation or denial of a license.
- Proposed section 2548.8(g): This provision makes the licensee/applicant's failure to honor contractual obligations set out in a viatical settlement contract a basis for revocation or denial of a license.
- Proposed section 2548.8(h): This provision makes the provider's failure to set up an escrow account pursuant to proposed section 2548.6 a basis for revocation or denial of a license.
- Proposed section 2548.8(i): This provision makes the licensee/applicant's having been refused a professional, occupational or vocational license, or having such suspended or revoked a potential basis for the revocation/denial of a license.
- Proposed section 2548.8(j): This provision makes the licensee/applicant's previous engaging in a fraudulent practice or having conducted any business in a fraudulent manner as a basis for the revocation or denial of a license.
- Proposed section 2548.8(k): This provision makes the licensee/applicant's knowing misrepresentation of the terms of a viatical settlement contract or investment a basis for revocation or denial of a license.
- Proposed section 2548.8(l): This provision makes the licensee/applicant's aiding or abetting any person in an act which would constitute grounds for the suspension, revocation or refusal of a license a basis for the revocation or denial of a license.
- Proposed section 2548.8(m): This provision makes a basis for revocation or denial of a license where the licensee or applicant has permitted any employee to violate any provision of the code or regulations.

IDENTIFICATION OF STUDIES

There are no specific studies relied upon in the adoption of this article.

SPECIFIC TECHNOLOGIES OR EQUIPMENT

Adoption of these regulations would not mandate the use of specific technologies or equipment.

ALTERNATIVES

The Commissioner has determined that no reasonable alternative exists to carry out the purpose for which these regulations are imposed.

ECONOMIC IMPACT ON SMALL BUSINESS

The proposed regulation will have an economic impact on small business to the extent that viatical settlement licensees will be required to open an escrow account, retain records of transactions for five years, and provide written disclosures to a viator at the time of an offer. There may also be an economic impact associated with the regulation's clarification that licensees cannot transfer any interest in a viatical settlement to a third party that is not licensed.

The Commissioner has identified no reasonable alternatives to the presently proposed regulations, nor have any such alternatives otherwise been identified and brought to the attention of the Department, that would lessen any impact on small business. Although performance standards were considered as an alternative, they were rejected, in part, because the kind of risks from which the regulations work to protect consumers cannot practicably be gauged by means of a performance standard.